

SUMMARY ANALYSIS OF AMENDED BILL

Author: Klehs Analyst: John Pavalasky Bill Number: AB 115
 Related Bills: _____ Telephone: 845-4335 Amended Date: June 20, 2005
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Conformity Act of 2005

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions, make corrections and additions to resolve issues arising during the department's legal review of bill as amended May 27, 2005.
- ☐ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☐ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- ☒ FURTHER AMENDMENTS NECESSARY.
- ☒ DEPARTMENT POSITION CHANGED TO Support.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 27, 2005, STILL APPLIES.
- ☒ OTHER – See comments below.

SUMMARY

This bill would change California's specified date of conformity to federal income tax law from January 1, 2001, to January 1, 2005, and thereby, in general, conform to the numerous changes made in federal income tax law during that four-year period.

SUMMARY OF AMENDMENTS

The June 20, 2005, amendments expanded low sulfur diesel fuel credit and expensing provisions as follows:

- To apply to taxable years beginning on or after July 1, 2005, instead of January 1, 2006, and before January 1, 2018, with respect to the credit, while retaining the January 1, 2009, repeal date of the expensing provision.
- To provide an exception to state certification when certification has been received under federal law.
- To extend the credit carryover period to total 11 years instead of seven years.

Also, the June 20, 2005, amendments make corrections and additions to resolve issues arising during the department's legal review of AB 115. In addition, three amendments would resolve conflicting sections in AB 115 and current session bills.

Board Position: <input checked="" type="checkbox"/> S <input type="checkbox"/> NA <input type="checkbox"/> NP <input type="checkbox"/> SA <input type="checkbox"/> O <input type="checkbox"/> NAR <input type="checkbox"/> N <input type="checkbox"/> OUA <input type="checkbox"/> PENDING	<table> <tr> <th data-bbox="945 1772 1360 1822">Legislative Director</th><th data-bbox="1360 1772 1576 1822">Date</th></tr> <tr> <td data-bbox="945 1822 1360 1959">Brian Putler</td><td data-bbox="1360 1822 1576 1959">6/28/05</td></tr> </table>	Legislative Director	Date	Brian Putler	6/28/05
Legislative Director	Date				
Brian Putler	6/28/05				

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. Thus, it would be effective immediately, and unless otherwise specified, it would apply to taxable years beginning on or after January 1, 2005. The provisions of this bill that conform to federal provisions that are subject to the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) termination date would apply to taxable years beginning before January 1, 2011. The June 20, 2005, amendments specifically make the low sulfur diesel fuel credit and expensing provisions to apply to taxable years beginning on or after July 1, 2005, instead of January 1, 2006. Also, the bill specifically makes full conformity to the student loan interest rules apply to taxable years beginning on or after January 1, 2007. In addition, the bill specifically provides that conformity to the federal health savings account (HSA) provisions is retroactive and is to be applied to taxable years beginning after December 31, 2003, with amended returns allowed.

POSITION

Support.

At its June 15, 2005, meeting the Franchise Tax Board voted 2 – 0, with the representative from the Department of Finance abstaining, to support AB 115.

The EFFECTIVE /OPERATIVE DATE and POSITION portions of the previous analysis of the bill as amended May 27, 2005, have been updated. The June 20, 2005, amendments specifically make the low sulfur diesel fuel credit and expensing provisions apply to taxable years beginning on or after July 1, 2005, instead of January 1, 2006. However, this six-month expansion of the operative period has an insignificant revenue impact due to rounding and thus, the ECONOMIC IMPACT in the analysis of the bill as amended May 27, 2005, still applies and is restated. The LEGAL IMPACT and ARGUMENTS/POLICY CONCERNS have not changed but are restated for convenience. The remainder of the analysis of the bill as amended May 27, 2005, still applies.

Summary of Suggested Amendments

The attached amendments are needed to resolve six technical issues as follows:

1. References to “this code” should instead be references to “this part.” Amendments 1, 2, 7, and 8 are provided to resolve this issue.
2. A comma is missing on page 30, line 10. Amendment 3 is provided to resolve this issue.
3. On page 35, line 16, the word “of” should instead be “or.” Amendment 4 is provided to resolve this issue.
4. The cross-reference to “Section 19183” on page 58, line 30, should instead refer to “Section 19173.” Amendment 5 is provided to resolve this issue.
5. On page 73, line 22, the deletion of a comma is incorrect. Amendment 6 is provided to resolve this issue.
6. On page 91, the phase-out formula in subdivision (b)(1)(B) of Section 24407 relating to the expensing of corporate organizational expenditures is intended to operate only when those expenditures exceed \$50,000. However, the “difference between” language contained in the bill could be interpreted to make the phase out apply even when those expenditures are below \$50,000. Amendments 9 and 10 are provided to resolve this issue.

SUMMARY OF ECONOMIC IMPACT

The June 20, 2005, amendments specifically make the low sulfur diesel fuel credit and expensing provisions to apply to taxable years beginning on or after July 1, 2005, instead of January 1, 2006. However, this six-month expansion of the operative period has an insignificant revenue impact due to rounding and thus, the ECONOMIC IMPACT in the analysis of the bill as amended May 27, 2005, still applies and is restated.

Revenue Estimate AB 115 As Amended June 20, 2005

Conformity to Provisions Changed in Federal Law Before 2004
Applies to Taxable Years Beginning On Or After January 1, 2005, Except as Noted

Federal Act Section	Description	(In millions)		
		2005-06	2006-07	2007-08
412	Economic Growth and Tax Relief Act of 2001 (PL 107-16) - Student Loan Interest.	\$0	-\$8	-\$15
404	JCWAA of 2002 (P.L. 107-147) - Expansion of the exclusion from income for qualified foster care payments.	-\$4	-\$3	-\$3
1201	Medicare Prescription Drug, Improvement, And Modernization Act of 2003 (P.L. 108-173) - Health savings accounts. Applies to taxable years beginning after December 31, 2003, with amended returns allowed.	-\$29	-\$18	-\$23

Conformity to the WFTRA of 2004 (PL 108-311)
And The AJCA (PL 108-357)
Applies to Taxable Years Beginning On Or After January 1, 2005

Federal Act Section	Provisions	(In millions)		
		2005-06	2006-07	2007-08
WFTRA 201-208	Uniform definition of child, etc.	-\$10	-\$7	-\$7
320	Disclosures relating to terrorist activities	-	-	-
322	Extension of expiring provisions-Availability of medical savings accounts	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
401-408	Technical amendments	-	-	-
AJCA 231	Members of family treated as 1 shareholder	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
232	Increase in number of eligible shareholders to 100	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
233	Expansion of bank S corporation eligible shareholders to include IRAs	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]

234	Disregard of unexercised powers of appointment in determining potential current beneficiaries of ESBT	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
235	Transfer of suspended losses incident to divorce, etc.	b/	b/	b/
236	Use of passive activity loss and at-risk amounts by qualified subchapter S trust income beneficiaries	b/	b/	b/
237	Exclusion of investment securities income from passive income test for bank S corporations.	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
238	Relief from inadvertently invalid qualified subchapter S subsidiary elections and terminations	b/	b/	b/
239	Information returns for qualified subchapter S subsidiaries.	b/	b/	b/
240	Repayment of loans for qualifying employer securities	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
243	Improvements related to real estate investment trusts	b/	b/	b/
247	Modification of unrelated business income limitation on investment in certain small business investment companies	b/	b/	b/
311	Special rules for livestock sold on account of weather-related conditions	-\$1	-\$1	f/
312	Payment of dividends on stock of cooperatives without reducing patronage dividends.	b/	b/	b/
315	Capital gain treatment under Section 631(b) to apply to outright sales by landowners.	b/	b/	b/
318	Certain expenses of rural letter carriers	b/	b/	b/
320	Exclusion for payments to individuals under National Health Service Corps loan repayment program and certain State loan repayment programs	b/	b/	b/
321	Modification of safe harbor rules for timber REITs.	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
322	Expensing of certain reforestation expenditures	-\$1	-\$1	f/
331	Net income from publicly traded partnerships treated as qualifying income of regulated investment companies	b/	b/	b/
335	Charitable contribution deduction for certain expenses incurred in support of Native Alaskan subsistence whaling	b/	b/	b/
338	Expensing of capital costs incurred in complying with Environmental Protection Agency sulfur regulations. Revenue same as AB 810 (Parra) as introduced. [2]	d/	b/	a/
339	Credit for production of low sulfur diesel fuel. Revenue same as AB 810 (Parra) as introduced. [2]	d/	-\$1	-\$1
702	Exclusion of gain or loss on sale or exchange of certain brownfield sites from unrelated business taxable income	b/	b/	b/
703	Civil rights tax relief	-\$1	-\$1	-\$1
704	Modification of class life for certain track facilities	-\$1	-\$1	-\$1
706	Certain Alaska natural gas pipeline property treated as 7-year property	\$0	\$0	\$0

708	Method of accounting for naval shipbuilders	-\$4	-\$7	-\$6
709	Modification of minimum cost requirement for transfer of excess pension assets.	Baseline loss [1]	Baseline loss [1]	Baseline loss [1]
811-820	Provisions relating to reportable transactions and tax shelters	Baseline gain [1]	Baseline gain [1]	Baseline gain [1]
831	Treatment of stripped interests in bond and preferred stock funds, etc.	e/	e/	c/
833	Disallowance of certain partnership loss transfers	e/ +Baseline gain [1]	e/ +Baseline gain [1]	e/ +Baseline gain [1]
834	No reduction of basis under Section 734 in stock held by partnership in corporate partner	e/	e/	e/
835	Repeal of special rules for FASITS	a/	a/	a/
836	Limitation on transfer or importation of built-in losses	e/ +Baseline gain [1]	\$1 +Baseline gain [1]	\$1 +Baseline gain [1]
838	Denial of deduction for interest on underpayments attributable to nondisclosed reportable transactions	a/	a/	a/
839	Clarification of rules for payment of estimated tax for certain deemed asset sales.	\$2	\$1	-
840	Recognition of gain from the sale of a principal residence acquired in a like-kind exchange within 5 years of sale	\$1	\$1	\$1
841	Prevention of mismatching of interest and original issue discount deductions and income inclusions in transactions with related foreign persons	\$2	\$3	\$1
842	Deposits made to suspend running of interest on potential underpayments	-\$2	d/	d/
843	Partial payment of tax liability in installment agreements.	\$1	c/	f/
845	Expanded disallowance of deduction for interest on convertible debt	\$3	\$3	\$3
847-849	Reform of tax treatment of certain leasing arrangements	\$3 +Baseline gain [1]	\$4 +Baseline gain [1]	\$5 +Baseline gain [1]
882	Treatment of charitable contributions of patents and similar property	e/	e/	e/
883	Increased reporting for noncash charitable contributions	a/	a/	a/
884	Donations of motor vehicles, boats, and airplanes	\$7	\$8	\$8
885	Treatment of nonqualified deferred compensation plans	Baseline gain [1]	Baseline gain [1]	Baseline gain [1]
886	Extension of amortization of intangibles to sports franchises	\$3	\$3	\$1
888	Modification of straddle rules	\$1	\$1	\$1
896	Recognition of cancellation of indebtedness income realized on satisfaction of debt with partnership interest	\$2	\$1	\$1

897	Denial of installment sale treatment for all readily tradable debt.	\$2	\$1	e/
898	Modification of treatment of transfers to creditors in divisive reorganizations	e/	e/	e/
899	Clarification of definition of nonqualified preferred stock	c/	c/	c/
902	Consistent amortization of periods for intangibles	\$5	\$15	\$15
903	Freeze of provisions regarding suspension of interest where Secretary fails to contact taxpayer [2]	\$2	\$2	\$1
905	Treatment of sale of stock acquired pursuant to exercise of stock options to comply with conflict-of-interest requirements	Baseline gain [1]	Baseline gain [1]	Baseline gain [1]
907	Limitation of employer deduction for certain entertainment expenses	\$6	\$6	\$7
	TOTAL (excluding baseline estimates and footnoted estimates)	-\$13	\$2	-\$12

[1] For baseline estimates see revenue impact discussion in the individual sections.

[2] Estimates based on State data. Otherwise, all estimates are based on Federal pro-rations.

a/ Insignificant gains of less than \$150,000

b/ Insignificant losses of less than \$150,000

c/ Negligible gains of less than \$250,000

d/ Negligible losses of less than \$250,000

e/ Minor gains of less than \$500,000

f/ Minor losses of less than \$500,000

LEGAL IMPACT

This bill contains provisions that would target certain provisions relating to low-sulfur diesel fuel to California.

The U.S. Court of Appeals for the 6th Circuit ruled in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738 that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. Ohio is seeking review by the U.S. Supreme Court. Although the outcome of this decision and its effects on the income tax credits of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

Recently introduced federal legislation titled the "Economic Development Act of 2005," S. 1066 and H. R. 2471, would authorize state tax incentives for economic development purposes that may otherwise be subject to constitutional challenge as discriminatory.

ARGUMENTS/POLICY CONCERNS

Conforming to federal tax law is generally desirable because it is less confusing for the taxpayer. With conformity, the taxpayer is required to know only one set of rules. Additionally, the taxpayer needs to maintain only one set of books. Conformity also eases the burden of the Franchise Tax Board to administer the law by utilizing many federal forms, instructions, and regulations. In addition, whenever possible the department uses federal information to verify that taxpayers pay the proper amount of tax. This eliminates the need for the taxpayer to submit the same information to both the IRS and the department.

LEGISLATIVE STAFF CONTACT

John Pavalasky
Franchise Tax Board
(916) 845-4335
john.pavalasky@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

Analyst	John Pavalasky
Telephone #	845-4335
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 115
As Amended June 20, 2005

AMENDMENT 1

On page 29, line 7, strikeout "this code," and insert:
this part,

AMENDMENT 2

On page 29, line 12, strikeout "this code" and insert:
this part

AMENDMENT 3

On page 30, line 10, strikeout "Code" and insert:
Code,

AMENDMENT 4

On page 35, line 16, strikeout "of" and insert:
or

AMENDMENT 5

On page 58, line 30, strikeout "19183" and insert:
19173

AMENDMENT 6

On page 73, line 22, strikeout "provided" and insert:
provided,

AMENDMENT 7

On page 89, line 8, strikeout "this code," and insert:
this part,

AMENDMENT 8

On page 89, line 13, ~~strikeout "this code"~~ and insert:
this part

AMENDMENT 9

On page 91, line 4, ~~strikeout "difference between"~~ and insert:
excess of

AMENDMENT 10

On page 91, line 6, ~~strikeout "and"~~ and insert:
over